China steps up efforts to stabilize yuan and curb capital outflows amid ongoing L-shaped growth

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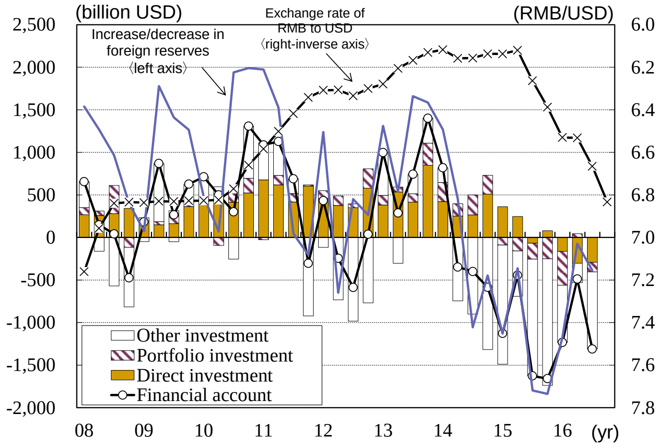
According to official economic figures, China's economy has entered into an L-shaped growth trajectory. Real GDP growth was +6.8% YoY in the Oct to Dec 2016, posting a slight increase following the three consecutive quarters of positive growth (+6.7% YoY). However, 2016's full-year real GDP growth stood at +6.7% YoY, falling below the 2015' figure of +6.9% YoY. The government continues to support the economy through increasing infrastructure investment, while pushing forward supply-side structural reforms, a core economic policy of the Xi Jinping administration, aimed at cutting excess production capacity.

Meanwhile, the government is concerned about the fact that investors consider sliding yuan and capital outflows as risk factors. The depreciation rate of the yuan against the US dollar throughout 2016 reached 6.6% and capital outflow of 303.2 billion dollar was recorded on the financial account balance (excluding foreign reserves) for the period from Jan to Sep 2016 (see chart 1). However, the amount of capital outflow is less than that of 319.7 billion dollar in the same quarter of 2015. The capital outflow mainly came from foreign debt payments in 2015, whereas in 2016 it attributed to the continued stronger growth in outward foreign direct investment compared to the sluggish inward foreign direct investment.

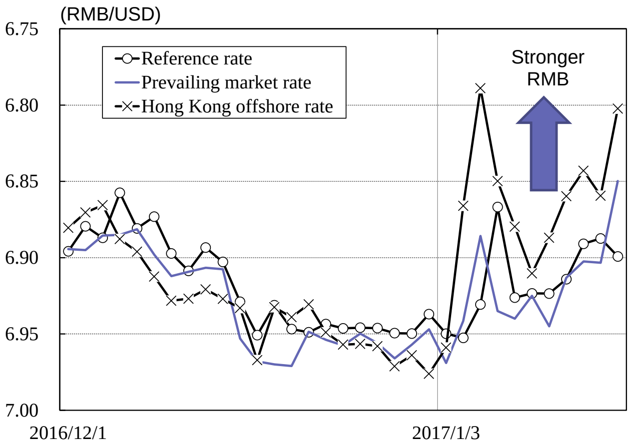
Given this situation, China has rolled out policies to stabilize the yuan and prevent capital outflows since the end of last year. Those government's measures include enhancing restrictions on capital transactions such as foreign remittances and foreign currency purchases by individuals, as well as changing the composition of the currency basket of the RMB index (at the start of this year) to soften the impact of the US dollar on the index by lowering the weightings of the US dollar and dollar-peg currencies. In addition, the government announced a policy to establish a long-term productive system, such as for stimulating the inward foreign direct investment through its wider market opening to foreign investors and for promoting a five-year plan aiming at higher value-added exports. Following a decline in the yuan against the US dollar in the beginning of the year, the monetary authorities strengthened yuan daily reference rate and curtailed the supply of the yuan in the Hong Kong offshore market, in an effort to drive the yuan higher against the dollar (see chart 2). The markets perceive that the depreciation of the yuan would be unavoidable now that the US interest rates have started their upward trend amid China's economic slowdown. Against such downward speculative pressure on the yuan, the government expressed its intention, through the above-mentioned actions, to take even tougher measures, despite the negative impact on actual economic activities. Besides, China faces more pressure from the US in trade and commerce, as Trump's administration is taking a tougher stance on China, insisting that the country to be designated as a currency manipulator. Based on this, the yuan is likely to be highly volatile for the time being.

Chart 1: China's Financial Account and Change in Foreign Reserves



Note: 1.The financial account does not include foreign reserves.
2. The increases or decreases in foreign reserves is difference in the balance from the previous period.
Source: State Administration of Foreign Exchange, BTMU Economic Research Office.

Chart 2: Changes in RMB Exchange Rates



Source: People's Bank of China and China Foreign Exchange Trade System,BTMU Economic research office.

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